(19) (16) (6)

Nos. 86-1380, 86-1424 and 87-469

In The

Supreme Court of the United States

October Term, 1986

ARKANSAS PUBLIC SERVICE COMMISSION, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ARKANSAS POWER & LIGHT COMPANY,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION, *et al.*,
Respondents.

REYNOLDS METALS COMPANY, *et al.*,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

**On Petitions For A Writ Of Certiorari
To The United States Court Of Appeals
For The District Of Columbia Circuit**

**BRIEF OPPOSING PETITIONS FOR CERTIORARI
ON BEHALF OF THE LOUISIANA PUBLIC SERVICE
COMMISSION AND STATE OF LOUISIANA**

Theodore (Ted) L. Jones
Post Office Box 65122
Baton Rouge, LA 70896

*Attorney for the
State of Louisiana*

Michael R. Fontham
Counsel of Record
Paul L. Zimmering
Noel J. Darce
Of STONE, PIGMAN,
WALTHER, WITTMANN
& HUTCHINSON,
546 Carondelet Street
New Orleans, LA 70130
Telephone: (504) 581-3200

Robert Rieger
General Counsel
Louisiana Public Service
Commission
Suite 1630
One American Place
Baton Rouge, LA 70825
Telephone: (504) 342-4429

*Attorneys for the Louisiana
Public Service Commission*

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
or call collect (402) 342-2831

25 pp

QUESTION PRESENTED

When the Federal Energy Regulatory Commission historically has regulated the "System Agreement" among operating companies in an electric holding company system, which governs wholesale exchanges of electric energy and reallocates the costs of generating units owned by the companies to equalize responsibility for the units, may the FERC reallocate the costs of an electric generation subsidiary owned by the holding company and created to supply wholesale energy to the System?

TABLE OF CONTENTS

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES—Continued

STATEMENT OF THE CASE

1. *Introduction.* The Federal Energy Regulatory Commission ("FERC") and its predecessor, the Federal Power Commission ("FPC"), historically have regulated agreements among the operating companies of the Middle South Utilities ("MSU") System; these agreements establish the terms for exchanging electric energy at wholesale and reapportioning the costs of generating units owned by the companies ("System Agreement"). The operating companies—which serve customers in four states—plan and operate their generation additions on a single system basis. The location, size and type of generating units are centrally planned to secure maximum economies, which often requires that some companies install more, and others less, than their proportionate amount of generating capacity, and that certain companies own disproportionate amounts of certain types of capacity. The System is operated as a single, integrated electric system from a central dispatch center, located in Arkansas. The purpose of the System Agreements has been to provide the basis for the central planning and operation of the System and for "equalizing among the Companies any imbalance of costs associated with the construction, ownership and operation of such facilities as are used for the mutual benefit of all the Companies." (App. 9a-13a; 9a).

In this case, the MSU companies filed two new agreements to apportion the costs of generating units built to serve the System. The 1982 System Agreement provided a new mechanism for equalizing the responsibility for generating capacity owned by the companies. A separate Unit Power Sales Agreement ("UPSA") was filed to

establish tariffs and allocate responsibility for the Grand Gulf 1 nuclear unit ("Grand Gulf"), located in Mississippi and owned by Middle South Energy, Inc. ("MSE"), a separate generating subsidiary owned by MSU. MSE subsequently changed its name to System Energy Resources, Inc., but will be referred to in this brief as MSE. The UPSA provided for the allocation of Grand Gulf among only three of the four operating companies—Louisiana Power & Light Co. ("LP&L"), New Orleans Public Service, Inc. ("NOPSI"), Mississippi Power & Light Co. ("MP&L") and Arkansas Power & Light Co. ("AP&L"). AP&L was a signatory to the UPSA, but was assigned no responsibility for Grand Gulf. (App. 19a-20a; 16a-17a; 19a).

The FERC affirmed findings of an administrative law judge that the Grand Gulf allocation in the UPSA was unreasonable and discriminatory. The ALJ and the FERC determined that past System Agreements had achieved a rough equalization of System generating costs among the companies. Because of huge cost escalations relating to two new nuclear units—the Waterford 3 unit, owned by LP&L, and Grand Gulf—the new capacity equalization mechanism in combination with the UPSA would result in a gross disparity in generation cost responsibilities. The FERC determined that this inequity could be remedied, and the rough pattern of cost equalization preserved, by reallocating Grand Gulf among all the operating companies to achieve a proportionate responsibility for the nuclear capacity costs of the System, and by approving the 1982 System Agreement. (App. 414a, 191a; 391a-92a; 190a; 392a; 410a-11a; 190a-91a; 193a, 132a-33a).

The FERC rejected arguments—raised by public and private parties in Arkansas and Missouri—that it had no jurisdiction to reallocate Grand Gulf. This decision was affirmed by the United States Court of Appeals for the District of Columbia Circuit ("court of appeals"). In three separate petitions for certiorari, the Arkansas and Missouri parties challenge the jurisdictional rulings of the FERC and the court of appeals. (App. 167a-71a; 99a-116a; 32a-61a; Pet. of Ark. Pub. Serv. Com'n, *et al.*, No. 86-1380; Pet. of AP&L, No. 86-1424; Pet. of Reynolds Metals Co., *et al.*, No. 87-469).

2. *MSU System planning.* MSU is a public utility holding company, which owns all the stock of four operating companies—LP&L, AP&L, MP&L and NOPSI. MSU also owns MSE and other subsidiaries. MSU, MSE and the operating companies have overlapping officers and directors. (App. 8a). The chief executive officers of the MSU companies comprise the board of directors of MSE and Middle South Services, Inc. ("MSS"), the service subsidiary of the System. (App. 8a; 289a).

Since 1930, the generation requirements of the operating companies have been centrally planned and constructed to achieve the most economical and efficient operation from the viewpoint of the System as a whole, rather than an individual operating company. The System Operating Committee—made up of representatives of the operating companies and MSS— plans the location, type and size of new generating units and assigns responsibility to construct the units to individual operating companies. The centralized planning approach permits the System to take advantage of economies of scale, local fuel

supplies and other advantages not available to individual operating companies. (*In the Matter of Electric Power & Light Corp.*, 29 S.E.C. 52, 55, 63-65 (1949); App. 289a; App. 10a; App. 392-393a).

The System planning approach caused certain operating companies to lack adequate generating capability for long periods, while others possessed excess capacity. One reason for this phenomenon was the desire to lower System generation costs by locating generating facilities in Louisiana, where abundant supplies of cheap natural gas existed. For more than two decades prior to 1980, AP&L was short of adequate generation and depended on the Louisiana companies to supply a large amount of its power and energy. (App. 292a-93a, 392a-93a).

When MSU embarked on a program of constructing nuclear and coal units, AP&L, as the historically short company and the one with least access to natural gas supplies, was assigned to construct the System's first two nuclear units, ANO 1 and ANO 2. These units had capacity costs somewhat higher than oil and gas units, but did not experience huge cost overruns, as they were installed before the nuclear industry began experiencing pervasive cost overruns. The units were very economical on a total cost basis because they have low fuel costs. In addition, AP&L was assigned the task of installing coal generation, which also was economical on a total cost basis because of relatively low fuel costs. (App. 394a-95a; 419a). The System planned two other nuclear units, Waterford 3 and Grand Gulf, which were beset by delays and huge cost escalations. The System assigned LP&L the responsibility to build Waterford 3 and MP&L the task of con-

structing Grand Gulf. Subsequently, when MP&L was unable to finance Grand Gulf, MSE was created to own and finance the unit. (App. 394a-95a; 419a; 233a-34a; 17a).

3. *System cost sharing.* Pursuant to System Agreements filed with the FPC and FERC, the MSU companies provided for sharing the costs of generating units planned for the System. The provisions for "capacity equalization" required that each company be responsible for a share of System generating capacity proportionate to its share of the System load. Thus, for instance, if a company had 30 per cent of the System load, it was required to bear responsibility for 30 per cent of the total kilowatts of System generating capacity. The "short" companies—those owning less than their proportionate shares of System generating capacity—made capacity equalization payments to the "long" companies. Thus, the System Agreements effectively reallocated the cost responsibility for generating units among the operating companies. (App. 388a-91a; 238a-39a; 11a-12a).

The 1951, 1973 and 1982 agreements all provided for each company to be responsible for its proportionate share of System generating capability, but the mechanisms for pricing the capacity have changed. Under the 1951 System Agreement a fixed dollar payment per kilowatt was made by the "short" companies to the "long" companies. The 1973 System Agreement reassigned capacity by requiring the "short" companies to pay a portion of the costs of a "participation unit," for which they received an entitlement to a proportionate share of the energy from the unit.

Both the 1951 and 1973 System Agreements achieved a rough equalization of System generation costs. The 1951

System Agreement worked because the average cost per kilowatt of capacity for each company was about the same. The capacity costs of the "participation units" under the 1973 System Agreement were sometimes more expensive than those of other units on the System, but fuel savings made the total costs comparable, so that the 1973 agreement also achieved a rough cost equalization. (App. 357a-58a, 411a-12a).

The 1982 System Agreement continues the historic pattern of "equalizing" generating capacity on a kilowatt-for-kilowatt basis, with each company responsible for its proportionate share of System kilowatts. The price paid per kilowatt is now based on the average cost of the oil and gas units owned by the "long" companies. Given the huge capacity costs of Waterford 3 and Grand Gulf, which are not offset by fuel savings, the concept of kilowatt-for-kilowatt equalization does not achieve cost equalization. Waterford 3 and Grand Gulf represent more than 70 per cent of the System's investment in generation facilities, but provide only about 13 per cent of System capacity. LP&L bore the *entire* cost of Waterford 3, yet is "short" of its proportionate share of kilowatts, and is required to make capacity equalization payments to other companies. To compound this problem, MSU in the UPSA proposed to allocate 38.57 per cent of the Grand Gulf to LP&L. The UPSA would have allocated 31.63 per cent of the unit to MP&L, 29.8 per cent to NOPSI, and *none* to AP&L. (App. 14a-16a; *see* App. 443a-44a; App. 19a n.27).

4. *Creation of MSE.* Like all major generating units in the MSU System, Grand Gulf was planned primarily to meet the needs of the System as a whole. The unit was originally assigned to MP&L, but financing pressure

forced the System to create MSE as a vehicle to finance it. MSE was incorporated in Arkansas. Its board is composed of the chief executive officers of the System. (App. 181a, 17a; Ct. App. Jt. App. 228; App. 289a).

All of the operating companies placed their credit support behind the Grand Gulf project and signed agreements obligating themselves for Grand Gulf costs. Initially, MSU was uncertain how Grand Gulf would be allocated, but anticipated that it might be allocated using the System Agreement. A number of allocation plans were considered by the System Operating Committee. In 1980, the MSS board of directors, consisting of all the System chief executive officers, adopted an allocation different from any proposed by the Operating Committee. AP&L was excused from purchasing any portion of Grand Gulf. According to an internal MSU memorandum, "[p]olitical and regulatory pressures" led AP&L to withdraw from the project. (App. 427a; 398a; 398a-99a; Ct. App. Jt. App. 676).

In 1981, the operating companies formalized the new allocation in a "reallocation agreement." AP&L was a party to the reallocation agreement. AP&L is also a party to the Unit Power Sales Agreement. As the administrative law judge in the Grand Gulf case found, "AP&L has been and is an active party and participant in the contracts and in the whole contractual process surrounding Grand Gulf to the same degree as LP&L, NOPSI and MP&L." (App. 428a).

5. *Decisions of the FERC and court of appeals.* The FERC approved the 1982 System Agreement, but reallocated Grand Gulf to equalize the nuclear investment cost

responsibility among the operating companies. It determined that, to achieve nondiscriminatory rates, the elimination of nuclear investment cost disparities was necessary. The FERC found that the 1982 System Agreement, in conjunction with the reallocation of Grand Gulf, would achieve a proper cost allocation on the System by preserving the historic pattern of rough cost equalization. This decision was initially affirmed by the court of appeals, but on rehearing was vacated and the case remanded for a better explanation of the reasons for employing this remedy. (App. 191a; 81a; 79a; Supp. App. 15a).

The jurisdictional contentions of the Arkansas-Missouri parties were rejected by the administrative law judge in the Grand Gulf case. (App. 427a-38a). As he noted, these arguments rested on an unfounded attempt "to depict AP&L as an independent utility which has expressly limited its involvement in the Unit Power Sales Agreement . . . . " (App. 427a). These assertions were also rejected by the administrative law judge in the case involving the 1982 System Agreement. (App. 299a-320a). The FERC rejected the jurisdictional arguments (App. 167a-72a).

In a thorough and unanimous analysis, the court of appeals set forth the affirmative basis for the Commission's jurisdiction and rejected each of the arguments raised by the Arkansas-Missouri parties. (App. 32a-61a). It found that the jurisdiction of the FERC over wholesale rates necessarily includes jurisdiction over generation costs, which comprise by far the largest component of wholesale rates. (App. 33a-35a). The court of appeals reviewed consistent precedents supporting its determination that the allocation of generation costs among affiliated

companies is subject to FERC jurisdiction, including this Court's decision in *Nantahala Power & Light Co. v. Thornburg*, 106 S.Ct. 2349 (1986). (App. 35a-38a, 44a-46a). It found that FERC jurisdiction in this context has additional merit because state regulatory agencies may act primarily to further their parochial concerns. (App. 51a-52a).

REASONS FOR DENYING THE WRIT

The 1982 System Agreement and the UPSA are contracts for the wholesale exchange of electric power and energy in interstate commerce among affiliates operating an integrated electric system. These interstate transactions are subject to the wholesale rate jurisdiction of the FERC, which includes jurisdiction over the costs associated with generating facilities. The FERC has regulated generation costs in wholesale rates and has allocated generation costs among the MSU companies for decades. The scope of FERC authority was recently confirmed by this court in *Nantahala Power & Light Co. v. Thornburg*, 106 S.Ct. 2349 (1986).

The objections to FERC jurisdiction are meritless. No basis exists for the contention that the FERC cannot require AP&L to purchase a share of Grand Gulf 1. Taken to its logical conclusion, this argument would prevent the FERC from ever modifying agreements among affiliates to reallocate generating costs, although this power is essential to ensure just, reasonable and nondiscriminatory rates. Moreover, the reallocation of Grand Gulf 1 costs does not improperly invade the jurisdiction of the states. These costs are treated like any other wholesale costs for

retail ratemaking; "prudence" issues and other ratemaking issues can and should be litigated at the FERC. Further, the exercise of FERC jurisdiction does not conflict with the Public Utilities Holding Company Act. This Act supports the exercise of FERC power over transactions that cannot be reached by local regulators.

1. The Federal Power Act provides jurisdiction to the FERC over 1) the interstate transmission of electric energy and 2) "the sale of electric energy at wholesale in interstate commerce," which means "a sale of electric energy to any person for resale." 16 U.S.C. § 824(b)(1), (d). This authority includes the power to regulate generation costs in setting wholesale rates. As this Court stated in *Federal Pow. Com'n v. Southern California Edison Corp.*, 376 U.S. 205 (1964), where it upheld the exercise of jurisdiction over a wholesale transaction, the Act makes the Commission's "jurisdiction plenary and extend[s] it to all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the States." *Id.* at 216.

The statutory exception of jurisdiction over generating facilities does not apply to the costs of generating facilities used to make wholesale sales. The exception is not in the sentence providing jurisdiction over interstate electric transmission and wholesale sales, but in the sentence granting jurisdiction over facilities. *See* 16 U.S.C. § 824(b)(1). Thus, the exception generally may prevent the FERC from regulating the *construction* of generating units, but not from regulating, adjusting or allocating generation costs in setting *rates* for wholesale sales. Further, the exception itself contains an exception, permitting the exercise of

jurisdiction as "specifically provided in this subchapter and subchapter III." 16 U.S.C. § 824(b)(1). The subchapter specifically permits the regulation of wholesale sales and all rates, charges, classifications and service associated with those sales. 16 U.S.C. § 824(b)(1), § 824d. Moreover, the nondiscrimination provision prohibits unreasonable differences in "rates, charges, service, *facilities*, or in any other respect," with respect to wholesale sales. 16 U.S.C. § 824d(b)(2) (emphasis added). These provisions grant the FERC plenary jurisdiction over wholesale sales in interstate commerce. The argument of the Arkansas-Missouri parties—to exclude generation costs from FERC jurisdiction—would eviscerate the authority of the FERC and roll back decades of practice and precedent.

The FERC typically exercises rate jurisdiction over all facilities used in connection with wholesale sales, including generating facilities. Indeed, the FERC actually requires a division of the retail and wholesale portions of generating plant and other plant in connection with many wholesale sales. It may use different allocation methods in separating this plant. *See* 18 C.F.R. §§ 35.13(h)(4)(iii), (h)(29), (h)(36). If the FERC could assert jurisdiction only over transmission facilities, it could regulate only a small portion of the costs of wholesale transactions.

The FERC traditionally has exercised jurisdiction over generation costs of the MSU System. The capability equalization provisions of the 1951, 1973 and 1982 System Agreements allocated generation costs, which constituted the biggest portion of System wholesale costs. The jurisdiction of the FERC to regulate these transactions never previously was questioned. Indeed, in 1982 the Fifth

Circuit affirmed a FERC decision approving amendments to the provisions allocating costs for generating capability and transmission investment. *Louisiana Pub. Serv. Com'n v. F.E.R.C.*, 688 F.2d 357 (5th Cir. 1982). In doing so, the court implicitly upheld the exercise of FERC jurisdiction. *Id.* at 358. Further, although the 1982 System Agreement reallocates the costs of generating facilities owned by the companies, the Arkansas-Missouri parties did not object to that exercise of jurisdiction over generating costs. They supported the agreement before the FERC, perhaps because AP&L is a "long" company and receives capacity equalization payments. (*See* App. 282a).

The exercise of jurisdiction over generating plants when they are used for wholesale electric sales is supported by the precedents. In an early case, *Hartford Elec. Light Co. v. Federal Pow. Com'n,* 131 F.2d 953 (2d Cir. 1942), the Second Circuit held that generating facilities used for wholesale sales were subject to FPC jurisdiction, and also offered a very restrictive interpretation of the "but" clause in Section 201(b) of the Act, which creates the exception for generating facilities. *Id.* at 962. Subsequently, in *Connecticut Light & Pow. Co. v. Federal Pow. Com'n,* 324 U.S. 515 (1945), this Court questioned the interpretation of the "but" clause, but appeared to approve the alternative jurisdictional ruling that where "the generating facilities were used as facilities for interstate wholesale sales, [they] therefore were within § 201(b)." *Id.* at 528 n.6.

Arguments very similar to those of the Arkansas-Missouri parties were considered and rejected in the Northern States Power cases. In *State of Minnesota v.*

F.E.R.C., 734 F.2d 1286 (8th Cir. 1984), the petitioner argued that the Northern States Power cost allocation agreement, which equalized generation and other costs among affiliated companies, was not a wholesale rate. The court rejected this argument, holding that the agreement established terms relating to interstate electric sales. *Id.* at 1288. In another case, the FERC allocated the costs of an abandoned nuclear plant among the affiliated companies. The costs were equalized in proportion to the average peak demands of the Northern States affiliates. The court affirmed the ruling over the objections of two state commissions. *South Dakota Pub. Util. Com'n v. F.E.R.C.*, 690 F.2d 674 (8th Cir. 1982). Additionally, two state courts held that the FERC ruling concerning the abandoned generating plant was preemptive because of the exclusive FERC jurisdiction over wholesale rates. *Northern States Pow. Co. v. Hagen*, 314 N.W.2d 32, 37 (N.D. 1981); *Northern States Pow. Co. v. Minnesota Pub. Util. Com'n*, 344 N.W.2d 374, 378, 382 (Minn. 1984).

The court of appeals also had ample precedent in its circuit for approving the exercise of FERC jurisdiction. In *Municipalities of Groton v. Federal Energy Reg. Com'n*, 587 F.2d 1296 (D.C. Cir. 1978), the court determined that the FERC has jurisdiction to adjust payments for generating deficiencies in a power pool. *Id.* at 1302. In *Mid-Tex. Elec. Co-Op, Inc. v. F.E.R.C.*, 773 F.2d 327 (D.C. Cir. 1985), the court went a step further, holding that the FERC has jurisdiction to include generating plant *construction work* in the costs used to fix wholesale rates. *Id.* at 344.

The scope of FERC jurisdiction was recently confirmed by this Court's ruling in *Nantahala Power & Light*

Co. v. Thornburg, 106 S.Ct. 2349 (1986). In *Nantahala,* the Court determined that where the FERC had established a utility's access to power entitlements in setting wholesale rates, a state agency could not adjust the entitlements differently in establishing retail rates. The Court recognized the exclusive authority of the FERC to regulate wholesale electric costs, which included the cost of generating the electricity. *See* 106 S.Ct. at 2359.

The Arkansas industrial parties seek to distinguish *Nantahala* by contending that the Court decided nothing about FERC jurisdiction, but only that a state may not engage in a collateral attack on a FERC decision that is properly made. (Pet. of Reynolds Metals Co., *et al.* at 20). But the implicit basis of the Court's ruling was that the FERC acted within its jurisdiction, because the doctrine of federal preemption requires a Congressional purpose to displace conflicting state law. *See Rice v. Santa Fe Elevator Corp.,* 331 U.S. 218, 229-30 (1947). The Court necessarily determined that the FERC properly exercised its jurisdiction or it could not have found that state authority was displaced.

The Arkansas public parties argue that *Nantahala* is distinguishable because it involved purchased power costs rather than the costs of a specific generating unit. (Pet. of Arkansas Pub. Serv. Com'n, *et al.* at 18-19). Apparently, these parties contend that the FERC may allocate the costs of many generating units lumped together, but may not allocate the costs of a single generating unit. This argument embodies an inverted and illogical view of the jurisdictional exception for generating facilities.

The jurisdictional ruling of the FERC and court of appeals is supported by decades of practice, the decisions

of this Court, and many other precedents. No basis exists to grant plenary review of the decision.

2. The Arkansas parties also attack the power of the FERC to reallocate Grand Gulf 1. They argue that the FERC cannot "force" a purchase or sale of electricity. Since these parties supported the UPSA and 1982 System Agreement as filed, they apparently contend that the FERC can *accept* an agreement among affiliates for the allocation of wholesale generation costs, but it may not reallocate the costs to avoid discrimination. (*See* App. 282a, 162a). This contention is meritless.

If the "forced" sale or "forced" purchase arguments had merit, the FERC could not make any adjustments to agreements for sharing costs among affiliated companies. An adjustment to a method for allocating capability responsibility in the MSU System, for instance, would be objectionable because it might make a "long" company "short" and require the purchase of additional megawatts. A "forced" sale or purchase would result from a decision to change the type of generating unit used to compute costs under the tariff. In a typical wholesale transaction, a change in the method of separating jurisdictional costs might require wholesale purchasers to pay for additional megawatts of capacity, causing a "forced" purchase. Were the Court to deny the FERC its power to require a "forced" sale or purchase that really is a fair reallocation of costs, it would repudiate the ratemaking jurisdiction granted in the Federal Power Act.

In this case, the FERC made an adjustment to the 1982 System Agreement that changed the capacity credits given the companies for firm purchases. (App. 207a-08a).

This adjustment had the effect of changing the responsibilities of individual companies for megawatts of System capacity from that specified in their agreement. Although this adjustment fits the Arkansas definition of a "forced" sale or purchase, the Arkansas parties do not even mention it in their petitions. Obviously, they believe the FERC had the power to make the adjustment.

The arguments of the Arkansas parties conflict with explicit language of the Federal Power Act. The statute not only empowers the FERC to disapprove unjust or discriminatory contracts, but to establish terms that are just and reasonable. Section 206(a) provides that the FERC, after finding a contract unreasonable, must "determine the just and reasonable . . . contract to be thereafter observed and in force, and shall fix the same by order." 16 U.S.C. § 824e(a). This provision is inconsistent with a "rubber stamp" theory.

The contentions of these parties are also flawed because they depend on a view that the MSU operating companies are separate, independent entities, which bargain at arms' length. (Pet. of AP&L at 2-3; Pet. of Reynolds Metals Co. at 18-19). Here, the MSU companies are part of a holding company system, operate their electric plants as a single integrated system, and allocate their generation and transmission costs pursuant to wholesale contracts. The FERC decision allocates these wholesale costs among the companies just as prior rulings did for decades.

The "forced purchase" arguments are also erroneous because the Grand Gulf plant was a System project involving all the operating companies, including AP&L; the UPSA is not an arms' length purchase agreement.

AP&L was fully involved in the decisions relating to Grand Gulf. Moreover, AP&L was a party to all of the agreements to finance and allocate Grand Gulf. (App. 427a-28a; 398a). Further, the reallocation agreement, which purports to relieve AP&L of cost responsibility for Grand Gulf, was conditioned on regulatory approval by the FERC. (*Id.*). The continuing and active role of AP&L in planning, financing and completing Grand Gulf precludes the view that it should escape responsibility for the cost of the unit.

3. The argument that the reallocation of Grand Gulf 1 costs is an undue intrusion into retail ratemaking is meritless. All wholesale sales are sales for resale; the cost to the purchaser necessarily becomes a component of rates to ultimate consumers. The MSU System Agreement for decades has reallocated generation costs among the companies and these costs were reflected in retail rates. The Arkansas parties did not complain when most of the up-front costs of White Bluff 1 & 2—two coal units owned by AP&L—were absorbed by Louisiana ratepayers pursuant to the 1973 System Agreement. Nor did they challenge the transfer of these costs pursuant to a temporary UPSA in the 1982 System Agreement. (*See* R., Docket ER82-483, tr. 1212-14). Their view of the intrusive effect of FERC jurisdiction apparently depends on whether AP&L incurs net benefits or costs under the FERC tariff.

Nor is it accurate to contend that the exercise of FERC jurisdiction creates a regulatory "gap" in reviewing the prudence of utility decisions. The FERC can and should determine the prudence issue; it is subsumed in the determination that rates are just and reasonable. The

FERC recently recognized that it has jurisdiction to decide the prudence issue in a case involving an UPSA executed by holding company affiliates. *AEP Generating Co.*, 38 FERC ¶ 61,243 (1987). Moreover, in this case the FERC did effectively determine the prudence-of-purchase issue when it decided on a reasonable and nondiscriminatory allocation of Grand Gulf.

In addition, the FERC decision does not alter state regulatory control over the construction decisions of utilities. Each state must make decisions regarding the certification of generating units, based on the needs of the MSU System and the individual companies. The Arkansas Commission—which portrays itself as ever-diligent—was content for decades when AP&L had inadequate capacity and depended on generators in Louisiana. Its newfound desire for stand-alone status results entirely from an unwillingness to pay unexpected costs associated with System planning.

None of the state regulatory agencies have ever certificated generating units in other states, although the costs of those units typically were transferred among states pursuant to the System Agreement. None of the regulatory commissions—other than the Mississippi Commission—had the opportunity to approve the construction of Grand Gulf. None of the operating companies have a need or desire to absorb Grand Gulf costs, but someone must pay these costs if MSU is to avoid bankruptcy. The FERC role is—as it always has been—to achieve a fair and nondiscriminatory distribution of these costs.

4. The Arkansas public parties contend that wholesale jurisdiction vanishes when the FERC recognizes the

"single System" operation of the MSU companies. (Pet. at 20-21). This contention is invalid. It is similar to the argument made, and rejected, in *State of Minnesota v. F.E.R.C.*, where System generation costs were equalized among affiliated companies. Moreover, the sales among the MSU affiliates are sales for resale regardless of the factors considered in allocating costs. Furthermore, these sales are beyond the reach of State regulators. Accepting the "no sale" argument would establish a regulatory "gap" for affiliated company power pools.

5. The Arkansas parties also rely on the Public Utility Holding Company Act, but their assertions stand reason on its head. The Arkansas public parties recognize, for instance, that the Act was designed to control monolithic corporations and prevent corporate manipulation of subsidiaries in various jurisdictions. (Pet. at 21). Yet the conclusion drawn by the Arkansas parties, that the FERC should adopt a hands-off stance in regulating MSU, is completely inconsistent with this goal. The FERC can prevent discrimination resulting from intercorporate transactions only if it exercises its regulatory power to prevent rate discrimination. The States cannot regulate wholesale sales and might well adopt protectionist positions if they could assert this jurisdiction.

CONCLUSION

The jurisdiction of the FERC over wholesale electric transactions includes the power to reallocate the costs of Grand Gulf. Generating costs make up the vast majority

of wholesale electric costs and the FERC has exercised jurisdiction over these costs for decades. The arguments of the Arkansas-Missouri parties conflict with the historic regulation of the MSU System by the FERC, the decisions of this Court, and decades of precedent. Moreover, these arguments rely heavily on a false portrayal of AP&L as a separate, independent entity, which planned its own generating resources apart from the System. The ruling of the court of appeals is firmly grounded in the facts and the law. No reason exists to grant certiorari.

Respectfully submitted,

Theodore (Ted) L. Jones
Post Office Box 65122
Baton Rouge, LA 70896

Attorney for the State of Louisiana

Michael R. Fontham
Counsel of Record
Paul L. Zimmering
Noel J. Darce
Of STONE, PIGMAN, WALTHER, WITTMANN & HUTCHINSON,
546 Carondelet Street
New Orleans, LA 70130
Telephone: (504) 581-3200

Robert Rieger
General Counsel
Louisiana Public Service Commission
Suite 1630
One American Place
Baton Rouge, LA 70825
Telephone: (504) 342-4429

Attorneys for the Louisiana Public Service Commission